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US Hegemony, Economic Integration and Monetary Regionalism in East Asia^{*}

Kristen Nordhaug^{**}

Introduction

In May 2000 a meeting of East Asian finance ministers in Chiang Mai in Thailand agreed on a regional monetary co-operation arrangement which would include the so-called ASEAN+3, i.e. the ASEAN countries along with Japan, South Korea and China. This has been followed up with discussions about an ASEAN+3 Free Trade Zone since November 2000.

It is still an open question whether these initiatives will succeed. In the 1990s initiatives for encompassing East Asian regional integration failed or were watered down. These efforts took place in rivalry with US-supported trans-Pacific 'open regionalism' and global organizations: The East Asian Economic Group/Caucus (EAEC) v. APEC in the early 1990s and the Asian Monetary Fund (AMF) v. the IMF during the 1997 Asian financial crisis. The East Asian Economic Group initiative came from Malaysia, while Japan was invited to assume leadership within the group. Yet the Japanese government declined to respond, probably because it worried about disturbances to its relations with the United States and regional dislike of a high-profile Japanese position. The outcome was a watered-down compromise where an East Asian Caucus was established as a subgroup within the APEC framework (Higgott and Stubbs 1995).

During the Asian financial crisis in 1997 Japan's Ministry of Finance proposed a US\$ 100 billion regional Asian Monetary Fund to provide quick emergency funds for stabilization of regional currencies, with most of the funding from Japan. This scheme was however strongly resisted by the United States that supported full control by the IMF of emergency funds. China also expressed opposition against Japanese 'yen hegemony'. Japan withdrew its proposal, and the IMF assumed control over the rescue funds.¹

Thus US dominance, Japanese reluctance to abandon its alliance with the United States and regional distrust regarding Japan seem to be major impediments to East

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¹ The AMF episode will be discussed further in section 3.

Asian regional organization. In the present paper these obstacles are related to cleavages in the regional East Asian state system with historical roots in the pre-1945 imperialist order and the regional Cold War order from the late 1940s until the early 1970s. These issues are discussed in part 1. Problems of East Asian monetary integration are also related to more recent features of East Asian development models, regional economic integration and the region's relationship with the refashioned US financial hegemony of the post-Bretton Woods period. These issues are discussed in part 2. The paper then discusses East Asian projects of monetary integration since 1997 in part 3. The paper concludes with an assessment of the impediments that the new initiatives will have to overcome. The discussion focuses on Japan; the East Asian Newly Industrializing Countries (EANICs), South Korea, Taiwan, Hong Kong and Singapore; the 'second generation' industrializers in Southeast Asia, Indonesia, Malaysia, Philippines and Thailand (ASEAN-4); and China.

1. The East Asian state system

Japanese imperialism and the Cold War

Most states of East and Southeast Asia have been European, US or Japanese colonies and did not become independent until the end of World War II. During the period from the 1840s to the 1940s the previous uncontested regional hegemonic power China was suffering heavily from the combined impact of domestic unrest, political fragmentation and imperialist infringement. Japan on the other hand managed to withstand Western imperialist pressure and developed into a regional imperialist power on her own in Northeast Asia. Japan's expansion took place at the expense of the (pre-1911) Chinese Empire and (post-1911) Nationalist China. Her major colonies had previously been part of the Chinese Empire (Taiwan, Manchuria) or were located within the Chinese sphere of interest (Korea).

In the 1930s Japan started to build up a regional war economy with the development of military-related heavy industry, an increasingly self-reliant regional division of labor and import-substituting industrialization within her colonial empire. The Japanese occupation of Manchuria in 1931 was followed by occupations of large tracts of China in 1937-38 and most of Southeast Asia in 1941. Japanese authorities developed the pan-Asian anti-Western notion of a Japan-led Greater East Asia Co-Prosperity Sphere that justified their invasions of the Western colonies of Southeast Asia.

The Pacific Wars of 1937-45 destabilized the region. Western colonists were ousted in Southeast Asia while the Nationalist government of China was weakened. The situation was destabilized further by the sudden capitulation of Japan in 1945.

This created a geopolitical vacuum and strengthened various forms of anti-colonial and nationalist movements. Communist parties throughout the region gained nationalist credentials and military experience from their fight against the Japanese and were frequently able to strengthen their position after the Japanese capitulation. In that respect Japanese imperialism prepared for the military strength and popular appeal of the Communist sides in the three important post-World War II regional civil wars of China, Korea and Vietnam, with strong US involvement on the non-communist side in the latter two.

The US Cold War strategy from the late 1940s was to promote regional integration of US allies centered around the defeated regional adversaries of World War II, West Germany and Japan, while economic and political contacts with the socialist bloc were restricted. In East Asia the People's Republic of China was the main adversary. Bilateral security ties were established between the United States and non-communist 'Pacific Rim' countries surrounding China from the late 1940s onwards, with Japan, South Korea, Taiwan, South Vietnam and Thailand as the main regional allies.

The US allied governments benefited from large amounts of economic and military aid, military procurement during the wars in Korea and Vietnam and relatively favorable conditions for export to the United States, while regional contacts were limited. Japan was soon 'graduated' from US aid. Yet it relied heavily on US military procurement during the Korean War and later on US export markets for its economic reconstruction. Eventually US authorities stepped up their efforts to integrate Japan into the Western world economy. In 1955 Japan with the backing of the United States became a member of GATT despite strong resistance from Britain. This allowed the well-organized Japanese exporters led by the Ministry of International Trade and Industry (MITI) to take advantage of the international trade boom from the late 1950s and expand their export to the West (Borden 1984: 186-190).

From the mid-to-late 1960s South Korea, Taiwan, Hong Kong and Singapore (the EANICs) also initiated export-promoting industrialization strategies. The developed countries in the West, especially the United States, served as the main markets of manufacturing exports from Japan and the EANICs. Still, the United States also sought to promote diplomatic reconciliation and trade and foreign investment links between Japan and her non-communist neighbors as part of its containment policy. The pre-1945 Japanese economy had relied on extensive trade and investment relations with the colonial empire in Taiwan, Korea and Manchuria as well as with other parts of East Asia. These relations declined after Japan's

defeat in World War II. Japan had to import from the United States a number of the raw materials that it earlier had drawn from the region, but lacked the dollar incomes necessary to pay for this. The country thus needed US aid. In order to solve these problems, US authorities on various occasions sought to renew Japan's trade with South Korea, Taiwan, China and Southeast Asia in order to strengthen the Japanese economy. After the Chinese involvement in the Korean War in November 1950 the option of establishing economic ties between Japan and China was closed. The United States established an embargo on China and focused on renewing economic ties between Japan and non-communist East Asian countries (McGlothlen 1993).

Rather than economic integration, the 1950s established the political foundation for regional economic integration, most notably through the 1951 San Francisco Peace Accord with Japan. The region was characterized by economic and geopolitical bilateralism, with the United States at the core as the source of military protection, aid and export markets. The United States controlled the foreign policy of its allies and established a network of US bases and military personnel in the region outside of the control of the host governments.

In the 1960s there were renewed efforts to accomplish non-communist regional integration. The main motive was to promote economic growth in order to contain communism in Southeast Asia with Japan as the locomotive.² This led to a series of piecemeal actions to improve bilateral relations between Japan and East Asian nations in the early 1960s. During the second half of the decade the United States co-operated with Japan to launch a more concerted multilateral effort at non-communist East Asian integration through the Asian Development Bank (Woo 1991: 91).

Helped by US support Japan's regional economic power expanded through foreign aid and foreign investment, although at a tortuous pace during the 1950s and 1960s. Large-scale Japanese FDI in manufacturing and resource extraction in East- and Southeast Asia resumed in the late 1960s when the government lifted its

² This was not just a continuation of the late 1940s US policy of finding an economic hinterland to Japan. Japan had recovered and was doing well in trade with Western countries. Now the idea was to use Japan to pull Southeast Asian countries away from communism, and to limit Japan's interest in increased economic interaction with the China mainland. The Americans envisioned that Japan increasingly would cover development aid in East Asia, while the United States specialized in security assistance. See 'Department of State Policy on the Future of Japan', June 26, 1964, Lyndon B. Johnson Library, National Security Files, box 250, doc. 70.

restrictions on foreign investment, increased throughout the 1970s and then stabilized during the first half of the 1980s before it boomed from the late 1980s.

The European contrast

The United States was instrumental in promoting Japanese-led regional economic integration during the Cold War. Yet the emergent state system of US Cold War allies was not favorable to strong political integration. A comparison with Europe may clarify this point:

European integration started in the 1950s, where the quest for Franco-German conciliation and integration became the core of a project to create economic union between the countries of 'little Europe'. Common norms of collective identity were stronger in 'little Europe' than in East Asia based on a commitment to liberal democracy. Later Spain, Portugal and Greece came under strong pressure to conform to these norms in order to become EU members. In contrast non-communist East Asia comprised of a wide variety of forms of rule, including monarchies, military dictatorships, personalized rule, democracies and single-party rule with limited possibilities for common identities (Katzenstein and Shiraishi 1997: 366).

The United States supported the gradual integration project of Europe. The Western European countries were at similar levels of development. France (and the other non-German EU states) related to Germany from a position of political strength. The division of Germany reduced the power capabilities of West Germany to the level of the other major European powers. The EU-institutions were designed so that West Germany would be controlled, its growing wealth also benefiting the other core countries.

In contrast, in East Asia, a new state system emerged from the decolonization process. There was never a realistic vision of a broad federation of US allies, which naturally would have been dominated by the old aggressor Japan. Undivided Japan was the only large partner to the United States and the only industrialized country in the region. The economic strength of Japan in per capita terms and even more so in absolute terms was a major impediment to regional political integration. Within this setting US regional geopolitical dominance through a series of bilateral ties with a disarmed Japan as the key ally became the preferred option to restrain Japan. This was also accepted within Japan itself as the country settled for a low-key diplomatic strategy, focusing on economic relations (Mjøset and Nordhaug 1999).

Transformation of the regional state system

The regional Cold War order began to dissolve from the early 1970s with the rapprochement between the United States and China and the US disengagement from Indochina. US aid to regional allies now dried out. Détente along with market economic reforms in China (from the end of the 1970s) and Vietnam (from the early 1980s) allowed for the integration of these socialist countries into the regional trade and investment system. From the 1970s the United States was pursuing a tough trade policy against Japan, and in the 1980s also against Taiwan and South Korea. Still the United States remained the region's single largest export market and the US trade deficit with the region was expanding in the 1980s.

In Southeast Asia a process of political integration took place with ASEAN as the key player. Indonesia, Malaysia, the Philippines, Singapore and Thailand established ASEAN in 1967. It was designed as a regional conflict management regime for negotiating disputes that had flared between the member states during 1965-67. ASEAN was later extended to include Brunei (1984), Vietnam (1995), Myanmar (1997), Laos (1997) and Cambodia (1999).

Common problems in the history of ASEAN strengthened its unity. During the early years ASEAN was loosely tied together by an anticommunist commitment, countering Chinese support to local revolutionary groups. From the mid-1970s the new socialist People's Republic of Vietnam became the main enemy, while the end of the Chinese Cultural Revolution, the Sino-American détente, and the Sino-Vietnamese conflict after the Vietnamese occupation of Cambodia in 1978 helped to improve relations with China in the 1980s (Frost 1990: 6-13). Then came a temporary decline in relations with China when the territorial disputes in the South China Sea intensified in the early-to-mid 1990s. This helped to improve relations with Vietnam that was included into ASEAN as a counterweight to China in 1995 (Castro 1998: 97-101).

In the 1990s ASEAN promoted region-wide dialogue on security issues through the ASEAN Regional Forum. An ASEAN Free Trade Area (AFTA) to reduce tariffs and ease restrictions on foreign investment over a 15 years period came into effect in 1993 (later the deadline was changed from 2008 to 2003). Still, intra-ASEAN trade has been limited. During the high-growth period 1990-97 there was only a modest increase in intra-ASEAN export as a proportion of total ASEAN export from 18.9 to 23.6 percent, and a significant part of this trade consisted of raw materials that were not legible for liberalization. By comparison the export of the original ASEAN countries Singapore, Malaysia, Indonesia, Philippines and Thailand to non-ASEAN Asian countries (mostly in East Asia) amounted to 35.1

percent of their total export in 1997.

‘The ASEAN way’ of co-operation may to some extent explain the limited accomplishments of ASEAN economic integration. The postcolonial setting of the ASEAN countries (excepting Thailand) has helped to fashion a strong common concern with national sovereignty that has been institutionalized in the organization. The binding power of ASEAN over its member states is limited as decisions are based on consensus. Reflecting concern about national sovereignty, ASEAN member states have not been willing to vest strong power in a central secretariat. Most administrative work is done by ASEAN secretariats housed in the foreign ministries of each member state (Stubbs 2000: 314).

AFTA has been marred by exceptions and non-tariff trade barriers. More fundamentally, it has only accomplished ‘shallow economic integration’. ASEAN has shied away from harmonization of trade, investment policies or macroeconomic integration. Concern about sovereignty has probably been reinforced by structural economic relations among the ASEAN countries. The lack of complementary economic relations within ASEAN-4 in terms of export production and export markets and their ensuing competitive relations impede deep integration (Schmidt 2002).³

A process of regional political integration has then been progressing at a moderate pace in Southeast Asia, bridging previous Cold War divisions. In contrast, in Northeast Asia divisions related to the region’s civil wars and the Cold War continued with hostilities between China and Taiwan and the two Koreas and the stationing of some 80,000 US troops in South Korea and Japan.⁴

It was previously noted that differences in level of economic strength between Japan and the other US East Asian allies precluded regional integration along European lines. With the turn to détente in the 1970s and strong economic growth in China in the 1980s this situation appeared to change. China – albeit still a very poor country in per capita terms – has developed into a formidable regional

³ East Asia appears to be dominated by a ‘Ricardian’ regional division of labour, where economic integration is strongest among countries with differing levels of economic development and complementary economic specialization. This is a major difference from EU economic integration with considerable intra-branch trade between countries with relatively similar levels of economic development.

⁴ In contrast, the major US military stronghold in Southeast Asia, the Subic Bay naval base in the Philippines was closed in 1992 and turned into civilian use.

economic power. Yet there have been few indications of conciliation between China and Japan. A deep Chinese distrust against Japan remained. This distrust was reinforced by the Japanese unwillingness to admit war crimes, an outcome of the strategically important position of the nationalist rightwing within Japan's ruling Liberal-Democratic Party. As long as this situation continues, 'the rise of China' is likely to promote sharpened regional rivalry between the two major East Asian powers, rather than anything resembling the Franco–German axis.

Furthermore, Japan has been reluctant to end its special security relationship with the United States. On the contrary, Japanese authorities have willingly ceded to US demands for military 'burden-sharing', possibly in order to win US acceptance of large Japanese trade surpluses and protectionist barriers. Japan is now subsidizing the US naval base in Okinawa, the key US military stronghold in East Asia. In that way the US–Japanese Cold War alliance has been preserved in the post-Cold War setting (Johnson 2001; Okazaki 2000).

Thus, Northeast Asian divisions and Japanese reliance on the United States both seem to be major obstacles to formalized regional political integration in East Asia. Still, East Asian regional economic integration is primarily driven from Northeast Asia through investment and investment-related trade. There are strong economic ties between Northeast and Southeast Asia, as well as within the 'Greater China' area of China, Hong Kong and the southeast provinces of China. On the other hand, economic ties among ASEAN members are fairly modest despite of a relatively developed regional political framework.

There is then a 'mismatch' in terms of regional political and economic integration. A relatively strong degree of political integration in Southeast Asia is not matched by a corresponding degree of economic integration. Conversely, relatively strong economic integration in Northeast Asia and between Northeast and Southeast Asia do not go along with an encompassing political framework. Regional economic integration has mainly takes place 'from below' through trade and investment. Integration is strongest between generations of East Asian industrializers with differing levels of economic development. Trade between these countries is to a large extent generated by foreign direct investment (FDI).

Economic integration is smoothened through a number of informal social and political arrangements, rather than through formal diplomacy. There are informal bilateral political contacts as seen in Japan's and Taiwan's foreign aid diplomacy, ethnic-based predominantly non-state networks and sub-regional arrangements as seen in the links between Singapore, Johore (Malaysia) and Riau (Indonesia) as

well as the 'Greater China area' of Taiwan, Hong Kong and China's Guangdong and Fujian provinces.

Let us now take a closer look at the process of East Asian regional economic integration, its accomplishments and limitations.

2. East Asian economic integration 1985-97

US seigniorage and East Asia

'The East Asian miracle' of the past two decades has been based on successful adjustment to US *seigniorage*. *Seigniorage* refers to advantages of controlling the world economy's reserve currency. In the post-Bretton Woods setting of the 1980s the Reagan administration learned that the United States did not face the same constraint as other countries to earn foreign exchange to pay for its import and foreign investment since most of its foreign trade was conducted in dollar. It could therefore endure huge current account deficits. The US current account deficit during 1975-79 had been 7.4 billion US\$. It increased to 146.5 billion in 1980-84, 660.6 billion in 1985-89, decreased to 324.4 billion during 1990-94, before it escalated to 990.4 billion during 1995-99 (Arrighi 2002: 22).

As shown by Giovanni Arrighi (2002) this led to a bifurcation of Third World growth trajectories. US competition for international capital funds and the ensuing international interest rate hike unleashed the Third World debt crisis with severe economic setbacks in Sub-Saharan Africa and Latin America. East Asian countries mostly had a lower level of debt than the countries of Latin America and Africa and were in a better position to take advantage of booming US export markets.⁵ Table 1 shows the East Asian ability to take advantage of growing US imports and trade deficits during the period 1985-2001.

US-Japanese relations

During the 1980s escalating US current account deficits went along with large federal deficits. The US Treasury Department ('US Treasury') financed the federal debt through the sale of Treasury securities (bills, notes and bonds, or simply 'Treasuries'). US hegemony was transformed from being based on manufacturing strength to a new financial power base thanks to its ability to attract capital funds from the rest of the world and reinvest them. Large-scale foreign purchases of long-

⁵ In his comparison of East Asia and Africa Arrighi (2002: 26-29) emphasizes East Asian advantages in terms of large regional labour supplies and indigenous entrepreneurship based on the overseas Chinese diasporas.

term Treasury Bonds helped to hold down the long-term US interest rate.⁶ The initial realization of these potentials of US *seigniorage* relied on a symbiotic relationship with Japan from the early 1980s onwards.

Table 1: US trade balance with select Asian countries 1985-2001 (billion US\$)

	1985-89	1990-94	1995-99	2000-01
Japan	-258.4	-259.1	-300.2	-150.6
EANICs				
S. Korea	-34.5	-11.6	-8.6	-25.5
Taiwan	-68.7	-48.9	-64.4	-31.4
Hong Kong	-25.3	-2.6	17.4	7.5
Singapore	-8.1	-8.1	-13.8	1.3
Sum EANICs	-136.7	-71.1	-69.5	-48.0
ASEAN-4				
Indonesia	-13.1	-10.9	-27.5	-15.5
Malaysia	-5.9	-19.5	-47.6	-27.6
Philippines	-3.7	-6.9	-17.1	-8.8
Thailand	-5.4	-18.4	-31.6	-18.5
Sum ASEAN-4	-28.1	-55.8	-123.8	-70.5
China	-14.2	-93.7	-248.6	-166.9
Sum Asian countries	-437.4	-479.7	-742.2	-436.0
Trade deficit with select Asian countries as % of total US deficit	n.d.	92.4	69.5	51.4

Source: Tabulated from U.S. Census Bureau 2002.

Large proportions of Japan's dollar current account surplus that mainly derived from its trade with the United States were invested in the United States, especially in the purchase of US Treasuries. 'Reaganomics' relied on Japanese capitalism to become viable (Murphy 1996). Also the Chinese (Chinese-dominated) states (semi-states) China, Hong Kong, Taiwan and Singapore built up large central bank reserves that they mostly invested in US Treasuries.

⁶ Eventually, the US manufacturing sector regained much of its previous industrial strength in the 1990s after a tough restructuring process in the 1980s, while the Clinton administration succeeded in balancing the budget. As for the geopolitical side of US hegemony, *seigniorage* allowed the Reagan administration to finance an arms race through massive deficit spending that broke the spine of the Soviet Union.

Persistent trade deficits in the United States and trade surpluses in Japan created an upward pressure on the yen exchange rate relatively to the dollar during 1985-95. This started in September 1985 when a meeting of finance ministers and central bank directors of the G-5 (United States, Japan, West Germany, France and United Kingdom) at the Plaza Hotel in New York agreed on concerted central bank intervention to bring down the dollar to a more competitive level. The initial rise of the yen was reinforced by the growing Japanese trade surpluses with the United States. A steep rise of the yen followed from 260 to one dollar in March 1985 to 120 in 1988 (Funabashi 1989: 261-266).

The Japanese real estate and stock market crash in the early 1990s led to a new round of appreciation of the yen as liquidity-strapped Japanese investors sold off assets in the United States to hurry the money back home to Japan. In result, yen demand increased and dollar demand decreased, pushing up the yen exchange rate further (Murphy 1996: 272). Also, during 1993-95 the Clinton administration attempted to pursue a tough trade policy along with efforts at 'talking down the dollar'. These US policies reinforced the effect of Japanese sales of dollar-denominated assets and reduced Japanese investment in the United States (Murphy 1996: 286-287). The yen exchange rate rose from 125 to one dollar in January 1993 to about 80 in March/April 1995. Thus the dollar exchange rate of the yen more than tripled during 1985-95.

In early 1995 the Treasury became worried about a slow-down of Japanese investments in Treasury Securities and possibly also hints from Japan's Ministry of Finance about the prospects of a major withdrawal of Japanese investments in US long-term Treasury Bonds. The latter would have led to a strong rise of US long-term interest rates. There was also concern about the inflationary impact of the weak dollar. From 1995 Treasury assumed control over US trade policies and economic relations with Japan and the ministries of finance and central banks of the two sides began to co-operate in order to strengthen the dollar relatively to the yen (Nordhaug 2001: 69-70; Nordhaug 2002).

Foreign direct investment

Japan's East Asian neighbors, especially Southeast Asia and China, benefited from the appreciation of the yen during 1985-95. There was a strong correlation between the yen exchange rate and Japanese FDI in Asia (with a due time lag from exchange rate changes to investment decisions). Periods with yen appreciation relatively to the dollar were followed by a strong growth of Japanese FDI, and conversely investment growth declined when the yen depreciated (Kwan 2001: 40). Thus, the strong yen of 1985-95 led to expanding Japanese FDI in East Asia.

Major Japanese companies responded to declining competitiveness by relocating core manufacturing export production to Japan's East Asian neighbors. Japanese annual FDI in manufacturing in South Korea, Taiwan, Singapore, Hong Kong, Indonesia, China, Thailand, Malaysia, Indonesia and the Philippines had been a little above US\$ 600 million per year during 1981-6. It increased to US\$ 2,370 million in 1987 (Pempel 1997: 60).⁷ In 1995 Japan's manufacturing direct investment in 'Asia' (mainly East Asia) stood at US\$ 8.1 billion.

Soon after the 1985 Plaza Agreement also South Korea and Taiwan faced US trade policy pressure to appreciate their currencies. Rising domestic wage levels and land prices undermined their competitiveness further within low-skill activities. In 1988 the US Congress 'graduated' Singapore, Hong Kong, Taiwan and South Korea from its Generalized System of Trade Preferences. Also it labeled Japan an 'unfair trade' under its 'Super 301' Trade Act, while Taiwan and South Korea escaped only due to trade opening on their part (Schmidt 2002). Thus, there was a worsening of the competitive position of Northeast Asia that coincided with devaluation and policy packages to promote export and foreign investment in Southeast Asia and China. Japanese investors in Southeast Asia were soon followed by investors from South Korea and Taiwan, contributing to growing economic integration between Northeast Asia and Southeast Asia and an economic boom in Southeast Asia from the late 1980s. Companies from Taiwan and Hong Kong were also investing heavily in Mainland China.

The Japanese foreign investment offensive in East Asia has been based on close co-operation between the Japanese government and major Japanese companies. A much more loose and diffuse type of networking with limited state-involvement evolved between ethnic Chinese in Hong Kong, Taiwan, the southern coastal provinces of China and Southeast Asia. For a long period of time overseas Chinese had developed ethnic networks based on speech group and ancestral descent. Some of these networks spanned over several countries in the Southeast Asian region. This allowed for swift dissemination of information, mobilization of cheap credits and movements of capital into new enterprises and geographical areas, access to labor from fellow underclass kinsmen and market outlets. The high mobility of capital within and across borders and the ethnic exclusiveness of economic interaction protected against confiscation by governments (Lim 1983: 3-4, 6; McVey 1992: 20-21).

⁷ These and the following figures underestimate the real investment level, as they do not include reinvestment of the affiliates' profit locally.

With the Chinese economic reforms of the 1980s overseas Chinese networks were strengthened between the Chinese states/semi-states Hong Kong, Taiwan and the China mainland. The Chinese government offered various incentives to attract foreign capital and know-how to export-oriented joint ventures with national actors, primarily state-owned enterprises, from the early 1980s. US and Japanese foreign investors remained cautious due to Chinese red tape, employment protection, poor quality and irregular supplies of raw materials and currency restrictions. However, overseas Chinese from Hong Kong and Taiwan were swiftly able to benefit from the Chinese opening (despite security-related discouragement and restrictions by the Taiwan government in the latter case). They were encouraged to invest in the China mainland by special inducements as part of Beijing's reunification policy of strengthening economic ties with Hong Kong and Taiwan. Thanks to their familiarity with local culture, language and manipulation of kinship and community ties, overseas Chinese foreign investors were also able to bypass regulations that hampered other foreign investors. When Japanese investment expanded in the Chinese mainland in the 1990s, overseas Chinese investors had already established a strong competitive position (So and Chiu 1994: 243-248).

Chinese business networks did also play a strong role in Southeast Asia. A three-tiered pattern of trade had emerged in most of Southeast Asia during the colonial period. The Europeans dominated the upper tier; Chinese occupied the middle tier; while the indigenous population was restricted to petty trade. These Chinese traders were able to move into economic positions that earlier had been held by the colonizers after de-colonization (McVey 1992: 20).⁸

Southeast Asian Chinese business was strengthened by the growing investment in the region from the late 1980s by Taiwanese and other overseas Chinese who had a strong preference for local Chinese partners. While Japanese investors frequently brought along their domestic supplier networks as they moved abroad, Chinese investors were more willing to co-operate with local Chinese suppliers (Jomo et al. 1997: 49).

The United States and other Western OECD countries were the main targets of the export of finished goods resulting from the build-up of regional manufacturing capacity through FDI from Japan and the EANICs. Relocation of export production helped the Northeast Asian countries to dispel some of the trade policy tension with

⁸ Similarly, in independent Thailand the removal of Europeans during World War II allowed Chinese to take over local banking.

the United States. As seen from table 1 Japan's trade surplus with the United States has been relatively stable after the late 1980s, while the surplus of the EANICs has declined. This went along with a strong increase in the surplus of the ASEAN-4 and China which received large investment from Japan and the NIEAs into their export manufacturing.

Investments from Japan and the EANICs have stimulated increasingly dense intra-regional trade in manufacturing inputs. However, Japanese companies normally declined to move production for Japanese markets abroad, only their production for regional markets and for export to third countries. Thus, export of finished manufactured goods from East Asia to Japan was depressed, while the region's imports of key inputs from the Japanese workshop increased. In result, regional trade deficits with Japan tended to grow, unless manufacturing trade deficits were compensated by exports of important raw materials to Japan. The East Asian countries then had to rely on trade surpluses earned with countries outside the region, especially with the United States, to cover their trade deficits with Japan (Bernard & Ravenhill 1995; Hatch & Yamamura 1996: ch. 10).⁹

The East Asian dollar bloc

Japan's strong position within regional producer networks was not matched by monetary strength. The yen has played a modest role in transactions outside the Japanese border as indicated by low and declining levels of international holdings of the yen, yen-denominated international bond issues and foreign exchange and trade transactions in the 1990s. Most of Japan's foreign trade has been paid in dollar, rather than yen, not only in its trade with the United States, but also with third countries, and most of the foreign lending by Japanese financial institutions has been dollar-denominated (Castellano 1999: 2-4; CFEOT 1999: appendices I.1-8).

East Asia was a dollar bloc, rather than a yen bloc, where most foreign trade and investment were conducted in dollar. Excepting Japan, most regional currencies were linked to the dollar from the mid-1980s until the 1997 regional currency crisis (including the currencies of China and Vietnam in the early-to-mid 1990s).¹⁰ This

⁹ China has however broken this pattern and is running trade surpluses with Japan as well as with the United States. Yet it is running a large trade deficit with Taiwan through indirect trade that mainly appears in the form of Hong Kong's large trade deficit with Taiwan.

¹⁰ Except from the Hong Kong dollar, nominal exchange rates of regional currencies were not pegged to the dollar. However, until the 1997 currency crisis most East Asian currencies were closely pegged to the US dollar in terms of consumer-price deflated real exchange rates. See McKinnon (2000: 38-40).

also meant that the currencies were loosely tied to one another. These arrangements protected against competitive devaluation and helped the countries to stabilize domestic price levels, while yen appreciation enhanced the region's competitiveness relatively to Japan and encouraged the inflow of Japanese investment (Sum 2002: 58; McKinnon 2000).

Despite of the unbalanced trade with Japan, there was a favorable and stable relationship between the Japan-led regional-national production order financed by export-oriented FDI and a monetary-financial order where regional currencies were linked to an American-dominated dollar-bloc regime and linked with a yen-appreciating bubble in the period 1985-95. Yet these two orders were also vulnerable to crises (Sum 2002).

East Asian models of accumulation and their destabilization

With the exception of the Philippines and partially also Taiwan, the EANICs, the ASEAN-4 and China, have had high rates of saving and investment as shown in table 2.¹¹ This may be viewed as a necessity of late industrialization. Excepting Japan, the countries were competing within export markets with low barriers to entry, while they were attempting to undertake industrial upgrading to conquer niche markets and move into high-profit yielding export markets.¹² Low profits and fast manufacturing expansion with industrial upgrading required large volumes of investment and credit (Sum 2002: 58).

¹¹ Wade and Venoroso (1998a) refer to an East Asian high-debt model characterized by high rates of saving and investment and banking systems that pool household savings to highly debt-leveraged companies overseen by governments that actively intervene in the financial systems and control the capital account. The Asian financial crisis is explained as a result of the destabilization of this order through financial liberalization. This model is far too generalizing as there are great regional variations in household saving, corporate debt-to-equity ratios, system of financial intermediation (banks or capital markets) and government intervention in the credit system.

¹² The NIEAs have come close to the stage of transition into high-profit yielding activities over the past decade, while the economies of Southeast Asia and China still are dominated by low-profit-low-barriers-to-entry export production. See Kaplinsky (1999) who argues that among the NIEAs Taiwan and Singapore are closest to a successful transition, while Korea and Hong Kong are more dubious.

Table 2: Saving, investment and GDP growth in select Asian countries 1981-95 (%-rates)

		Average19 81-90	1991	1992	1993	1994	1995
NIEAs							
Hong Kong	Saving	33.5	33.8	33.8	34.6	33.9	34.5
	Investment	27.2	27.2	28.5	27.6	31.8	33.1
	GDP growth	6.9	5.1	6.3	6.4	5.4	4.6
South Korea	Saving	32.4	36.4	35.2	35.4	35.5	37.0
	Investment	30.6	38.9	36.6	35.1	35.9	36.0
	GDP growth	12.7	9.1	5.1	5.8	8.4	9.2
Singapore	Saving	41.8	44.0	45.6	46.3	51.3	55.6
	Investment	41.7	35.1	36.0	37.7	32.2	33.9
	GDP growth	6.5	6.7	6.3	10.1	10.1	8.9
Taiwan	Saving	32.9	27.8	27.0	27.0	25.8	26.3
	Investment	22.8	23.3	24.9	25.2	23.9	24.5
	GDP growth	8.0	7.6	6.8	6.3	6.5	6.3
Country average	Saving	35.2	35.5	35.2	35.7	36.6	38.4
	Investment	30.6	31.4	31.5	30.9	31.0	33.4
	GDP growth	8.5	7.1	6.1	6.3	7.6	7.3
ASEAN-4							
Thailand	Saving	26.2	27.2	35.2	35.6	35.2	34.2
	Investment	30.7	42.7	40.0	39.9	41.0	40.0
	GDP growth	7.9	8.5	8.1	8.8	8.7	8.6
Malaysia	Saving	33.2	32.0	36.5	37.7	37.6	37.2
	Investment	30.6	35.8	35.1	37.8	38.7	40.6
	GDP growth	5.2	8.6	7.8	8.3	9.2	9.3
Indonesia	Saving	30.9	33.5	35.3	32.5	35.3	36.0
	Investment	29.3	32.0	32.4	29.5	34.0	38.3
	GDP growth	6.0	8.9	7.2	7.3	7.5	7.6
Philippines	Saving	22.2	16.6	17.0	15.2	14.9	14.7
	Investment	22.0	20.2	20.8	23.6	23.5	21.6
	GDP growth	1.0	-0.6	0.3	2.1	4.4	4.8
Country average	Saving	28.1	27.3	31.0	30.3	30.8	30.5
	Investment	28.2	32.7	32.1	32.7	34.3	35.4
	GDP growth	5.0	6.4	5.9	6.6	7.5	7.6
China	Saving	30.8	38.1	38.3	41.5	41.4	42.2
	Investment	30.5	35.4	37.3	43.5	40.0	39.5
	GDP growth	10.4	9.3	14.2	13.5	11.8	10.2

Source: ADB 1996/1997: tables A1, A7, A8.

The high investment levels increased the risk of over-investment for export markets that would depress export prices and profitability. There were limited possibilities to respond to declining prices in finished goods export markets outside the region

with production for national and regional markets, as the mirror image of the region's high saving and investment rates was low consumption rates. During the 1990s high regional rates of corporate investment went along with declining rates of return in most of the NIEAs and ASEAN-4 countries. There were also spectacular cases of over-investment, such as South Korea's expansion in Dynamic Random Memory chips (DRAMs) that caused a 90 percent plunge in world market prices in 1996. An alternative strategy was to divert more investment into securities and real estate. That frequently led to new second-order over-investment problems as seen in the bursting of Bangkok's real estate bubble in 1996 (Sum 2002: 59, 61-62).

The regional financial order and monetary regime reinforced tendencies of overproduction and over-investment with lowered investment quality. On the supply side financial inflows in the 1990s were enhanced by the renewed inflow of First World financial capital into the Third World after the debt crisis of the 1980s and by the bursting of the Japanese bubble. Japan's ensuing economic stagnation and loose post-bubble monetary policies from 1992 with low interest rates created surplus liquidity which 'leaked out' to East Asia. Japan dominated foreign direct investment and lending to East Asia, while most of the foreign portfolio investment to the region came from the United States and Europe. Yet much of the funding of the portfolio investments initially came from Japan. International investors engaged in the so-called yen carry trade through borrowing at low interest rates in Japan, exchanging yen into dollar and re-investing throughout the world, including East Asia (Bevacqua 1998: p. 414-415). Most East Asian countries (with exceptions such as China and Taiwan) liberalized their capital accounts to attract these funds from the early 1990s.

As seen from table 2 the investment rates of ASEAN-4 were generally higher than their saving rates. This saving-investment gap was covered by capital inflows. In the early 1990s some of these countries had experienced a decline of FDI inflows, to a large extent because of the growing competition from China. They responded with capital account liberalization in order to attract financial flows. The combination of capital account deregulation, strong growth, monetary stability with de facto dollar pegs, high local interest rates and/or lucrative markets in securities and real estate encouraged large inflows of loans (frequently short term) and portfolio investment. With these volatile forms of capital and the build up of foreign debt the countries became increasingly reliant on investor confidence, and the maintenance of their dollar peg.

Net private foreign investment in South Korea, Indonesia, Malaysia, Thailand and the Philippines increased from US\$ 40.5 billion in 1994 to 93.0 billion in 1996 (Radelet & Sachs 1998: appendix, table 1). As these inflows of foreign capital were exchanged for domestic currencies, the resulting demand wielded an upward pressure on local currency exchange rates and created an inflationary pressure. The growth of money supply exceeded GDP growth. This resulted in excess liquidity, which fuelled an extremely high level of investment. In result there was a rise in the level of 'bad investment': various kinds of asset speculation and investment in industrial over-capacity (Bevacqua 1998: 416; Wade 2000: 102).

East Asian foreign debt soared as a result of the inflow of loans. Large proportions of these loans were short-term (one year maturity or less) which were used to finance long-term investment, and renewed on a regular base. Much of the lending was not hedged against exchange rate changes and growing foreign debt complicated the option a 'soft landing' by abandoning the monetary pegs. In Indonesia, Thailand and South Korea – which all would receive 'rescue packages' from the IMF – short-term debt exceeded foreign reserves, and grew at a faster pace than these reserves (Radelet & Sachs 1998: appendix, table 3). Economic stability then relied on the willingness of foreign lenders to renew short-term loans.

The region was also adversely affected by the depreciation of the yen following the 1995 'reverse Plaza agreement'. The declining yen affected regional competitiveness within higher end East Asian manufacturing directly involved in competition with Japanese products, especially in South Korea and reduced the growth in Japanese foreign investment (Kwan 2001: 41-43). The 'rise of China' weakened the competitiveness of ASEAN-4 within lower-end manufacturing. Chinese exports were boosted by devaluations in 1990 and 1994, wages were lower than in Thailand and Malaysia, while the skills and level of education of the Chinese labor force frequently were better than in ASEAN-4. ASEAN-4 exports were increasingly compressed to a narrow range of electronic products leading to enhanced economic vulnerability (Lo 1999; Hughes 2000: 238-240, table 4).

Declining export growth and growing current account deficits probably weakened foreign investor confidence in regional assets and currencies, and the countries were becoming increasingly vulnerable to sudden capital outflows. Eventually investors began to sell away Southeast Asian currencies during May and June 1997 and a number of major Thai financial institutions failed. By July 2 the Bank of Thailand was forced to float the baht. This was followed by regional contamination in Southeast Asia. Foreign lenders refused to renew loans falling due. Large-scale dumping of assets and currencies pushed down their values. The Philippines, Malaysia and Indonesia were forced to abandon their currency pegs in July and

August. In the next round attention shifted to Taiwan, leading to a moderate depreciation of the NT dollar in October 1997, while the Korean won was floated in late November.

A US\$ 93.0 billion *net inflow* of private capital to South Korea, Thailand, Malaysia, Indonesia and the Philippines in 1996 changed to a US\$ 12.1 billion *net outflow* in 1997 (Radelet & Sachs 1998: appendix, table 1). The countries were now caught in vicious circles of currency depreciation, increased foreign debt and collapse of domestic financial institutions and had to go to the IMF to ask for emergency credits. Stand-by agreements were signed by Thailand (5 August), Indonesia (31 October) and South Korea (4 December), while the Philippines extended a previous IMF agreement.

Regional economic integration and impediments to monetary integration

Let us now try to relate the previous discussion of East Asian regional integration and development models during 1985-97 to the question of regional monetary co-operation. It has been pointed out that East Asia's export boom to a large extent has been based on successful adjustment to US monetary *seigniorage*. This has been based on the region's ability to take advantage of the strong growth of US imports closely related to the US dollar hegemony. US *seigniorage* was underwritten further by the use of the dollar in trade and investment relations with third parties, by the tying of regional currencies to the dollar and by reinvesting regional dollar reserves (directly or indirectly deriving from US current account deficits) in US Treasuries. Stated differently, US *seigniorage* allowed for a complementary relationship between US over-consumption and East Asian under-consumption. Much of the dollars earned by the high-saving, high-investing East Asian countries in their trade with the United States were reinvested in US Treasuries and other US securities, thus sustaining the investment rate of the high-consuming, low-saving United States.

The regional adjustment to a dollar standard and Japan's interest in holding down the yen exchange rate were major impediments to monetary regionalization, which naturally would have been based on the yen. Also, monetary arrangements which involved the pooling of central bank reserves were impeded by the practice of investing these reserves in US Treasuries, and Japan's interest in using its Treasury holdings as a lever in its bargaining with the United States.

However, the Asian financial crisis demonstrated some of the financial and monetary vulnerabilities of regional development models. This can be seen as a dilemma of late development: There is a strong imperative to maintain high levels

of investment, but that can easily lead to economic overheating and a lowering of investment quality. This becomes all the more dangerous when countries liberalize their capital accounts to attract volatile financial funds. These tendencies could possibly be contained or dampened by effective regional monetary co-operation.

3. East Asian monetary integration efforts

AMF v. IMF

The IMF required the closing of financial institutions, the enforcement of strict regulatory standards and liberalization of the financial system and the capital account in return for emergency funds. At best these policies had little relevance in stemming the crisis. At worst they enhanced investor panic. The most serious case was the abrupt closing of sixteen commercial banks in Indonesia during autumn 1997, which caused a run, also on healthy banks. The IMF was also demanding policies of fiscal contraction and discount rate increase in a failed attempt to stabilize East Asian currencies. These pro-cyclical policies had a serious effect on regional markets and starved local business of credits. Zealous demands for budget surpluses, which the countries failed to meet and high interest rates that expanded the domestic debt weakened the foreign investors' confidence. The IMF attempted to act as an international lender of last resort, rather than mediating in the rescheduling of debt payment, as it had done in the Latin American crisis of the 1980s. Yet it failed to deliver on its promise. Emergency funds were sliced in tranches to be disbursed over the program period, pending adjustment performance. These tranches were too small compared to the debt falling due to stem the panic, and disbursement was delayed by drawn-out complicated negotiations (Radelet & Sachs 1998: 34-37).

Disillusioned by the IMF's poor performance in Thailand and the US unwillingness to contribute to the bailout fund for Thailand, the ASEAN countries in August 1997 officially proposed a permanent regional Asian Monetary Fund (AMF) financed by the East Asian countries. The real driving force in this initiative was Japan's Ministry of Finance.¹³ The AMF should operate at the regional level to maintain monetary stability. Its total funding would be about US\$ 100 billion with Japan as the main contributor.

¹³ Surprisingly, the idea for an AMF financed by Japan probably came from IMF director Michel Camdessus, who feared a shortage of funding for the rescue operations as the United States declined to contribute during the early phase of the crisis. Japan's Vice Finance Minister of International Affairs, Eisuke Sakakibara, took up the idea and presented it as his own. Camdessus later changed his position as the US Treasury, which had not been informed, began to resist the AMF and promised more generous US emergency funds. I thank Robert Wade for this information.

Tokyo had a strong interest in stabilizing the financial systems of the region. In 1996 Japanese banks had US\$ 265 billion in outstanding loans to East Asian countries, and US\$ 83.9 billion to the three countries that eventually would have to be bailed out, Thailand, Indonesia and South Korea (Altback 1997: 5). A regional financial collapse would enhance Japan's bad debt problem. Tokyo did apparently not trust the IMF to solve these problems.

Japan floated the AMF idea during a G-7 meeting in Hong Kong in September 1997. The EU countries and the IMF immediately objected to the proposal. During the annual meeting of the IMF and the World Bank in Hong Kong in September/October US Vice Secretary of the Treasury, Larry Summers also strongly resisted the initiative.¹⁴ The Treasury attempted to accommodate the East Asian countries by assuming a greater responsibility for the emergency funds in return for an abandonment of the AMF plans.

The Western critics argued that two rivaling monetary funds would create problems of 'moral hazard' by allowing for access to emergency funds without reform. From the Treasury's viewpoint the AMF would reduce the US influence on the adjustment processes and impede liberalization of trade and finance. In particular the latter was a major US concern during the crisis. Concern about East Asian holdings of Treasuries may also have been important. If regional central banks led by the Bank of Japan had sold out from their holdings of Treasuries to finance this costly operation, US long-term interest rates would have soared (Johnson 1998: 658).

China was also resisting the AMF initiative as an effort to impose 'yen hegemony' on East Asia (Rowley 2000a: 23). In addition to its support of the US/IMF line China also contributed to the IMF emergency funds and pledged not to devalue the *renminbi*. The Chinese defense of the *renminbi* (which also helped the Hong Kong monetary authority to maintain its peg) was most important to the stabilization of regional currency exchange rates in 1998. These actions sustained China's rivalry with Japan for regional hegemony. By mid-1998 Beijing criticized the Japanese

¹⁴ During the conference Japan's Eisuke Sakakibara called a meeting of senior Asian officials to discuss the AMF proposal without informing the US representatives. As Summers learned about this meeting he entered the room where the Asians were sitting, sat down at the table and said, 'Now, where were we?' See Wade (1999: 147, note 46).

side for allowing the yen to decline.¹⁵ China's pro-IMF line was probably also motivated by a strategy of accommodating the United States. In return Beijing hoped for US concessions in the ongoing negotiations on China's entry into the WTO (Bowles 2002: 255-257).

Japan withdrew from the AMF proposal and the other East Asian countries gradually followed suit. The AMF initiative was abandoned in November 1997. APEC's meeting in Vancouver 23-24 November backed IMF's leadership in the financial rescue operation. Shortly afterwards Tokyo announced that its contribution to the regional emergency fund 'only' would be about US\$ 20 billion (Rowley 1997).

There is reason to believe that the 'contagion' from the Thai crisis could have been much reduced if the AMF had been in place by September/October 1997. The foreign investors' knowledge of a US\$ 100 billion defense line ready to be issued on short notice might have calmed down the market in a period when regional currencies, excepting the Thai baht, still were relatively stable (Felix 1998). Instead, the Asian financial crisis escalated and reinforced the Japanese crisis in late 1997.

The New Miyazawa Initiative

The 'contagion' of the Asian financial crisis was felt in the United States by mid-1998. US equity prices were depressed and some highly leveraged institutional investors, such as hedge fund Long Term Capital Management (LTCM), were caught in a liquidity squeeze. By late September 1998 the US economy was close to the brink, and reduced US demand threatened to reinforce the international crisis to the point of a full-scale world depression. The Federal Reserve responded with organizing a bail-out of LTCM along with three successive reductions of the discount rate from late September through mid-November. These actions calmed uneasy investors by signaling support of the US stock market and consumption boom (Brenner 2000: 20-23). The U.S. interest rate reduction allowed the East Asian countries to reduce their interest rates without triggering capital flight. This dampened domestic debt problems and sustained domestic demand (Jomo 2001: 287). The surge of the US economy in 1999 helped East Asian exports.

The US boom relied heavily on foreign inflows of capital, but to a greater extent than previously the capital inflow came from Europe, rather than Japan and other

¹⁵ China's words were not always in accordance with her deeds. While China criticized the United States and Japan for not doing more to support the yen, the Chinese central bank sold off billions of dollars worth from its yen holdings. See Wade and Venoroso 1998b: 27, note 36).

East Asian countries. The weakening of economic ties between the United States and Japan was accompanied by growing friction over trade policy issues. This appears to have been an important background for new Japanese initiatives for regional monetary integration that first came in the form of a major Japanese aid initiative.

During 1998 US authorities criticized Japan's handling of its banking crisis as well as Japan's declining imports from the region. The United States enlisted support from the G-7 and East Asia for this critique. Japan came under strong pressure to expand government deficits and imports to promote regional recovery. At APEC's trade ministers' meeting in Kuala Lumpur in June 1998 an isolated Japan was pressured on 'Early Voluntary Sector Liberalization' within marine and forestry products. Eventually, the Japanese government responded by launching a massive economic stimulus and bank bailout package in October 1998 along with a regional aid initiative that diluted the pressure for trade liberalization (Hughes 2000: 232-233).

At a G-7 meeting in Washington in October 1998 Japan's Minister of Finance, Kiichi Miyazawa presented a US\$ 30 billion aid plan in soft credits to Indonesia, Malaysia, the Philippines, Thailand and South Korea. Loans made under the plan would be denominated in yen and tied to projects involving Japanese companies. Japan was couching the idea in the context of a broader aid effort involving the G-7 countries, the IMF and the World Bank, and thus diluted resistance from the United States and the IMF. Additional Japanese aid commitments followed in December 1998 and during spring 1999 (Vatikiotis with Hiebert 1998/99; Castellano 2000: 2). These Japanese funds provided an alternative source of emergency credits without the stringent conditions that accompanied IMF support.¹⁶

One indication of the success of the Japanese initiative was that East Asian countries in November 1998 declined to force the 'Early Voluntary Sector Liberalization' within marine and forestry products through APEC's agenda. The compromise solution was to defer a decision to the WTO (Hughes 2000: 246). But apart from trade policy, Tokyo's regional aid policy was also closely related to its efforts to internationalize the yen.

¹⁶ Christopher Hughes (2000: 222) suggests that the competition from the Miyazawa plan pressured the IMF to take a milder stance towards the East Asian countries.

Regionalization of the yen

For a long time it had been a deliberate strategy from the side of Japan's Ministry of Finance (MOF) to reduce the international use of the yen in order to hold down the yen exchange rate. However, by mid-1998 the MOF began to advocate the internationalization of the yen, focusing on the promoting the yen in East Asia.

It was argued that an internationalization of the yen would enhance the competitiveness of Japan's financial institutions. Japan's capital market would benefit from yen investments by foreigners and the foreign exchange risks of trade and capital transactions would be reduced (CFEOT 1998, 1999). The pressure to market Japan's government debt may have played an important role in these deliberations.

MOF has managed the government debt through a controlled system of government bond purchases. The bonds have been sold to banks and security firms with no choice but to follow the MOF's request and to the MOF's trust fund bureau, which is funded by the postal savings system. These measures have kept bond rates and long-term interest rates low. But the banking crisis had reduced the banks' capacity to purchase unprofitable bonds, and the postal saving system has become increasingly burdened. The government is then under pressure to turn to 'real' bond markets at home and abroad. Bond rates and long-term interest rates must then be raised (Murphy 2000: 37-38, 50). Accordingly, the marketing of Japanese government securities internationally has become a main concern. By internationalizing the yen Japan may be able to attract East Asian current account surpluses into government bonds.

The Euro was launched in 1999. The MOF predicted that it would become a strong competitor to the dollar with 'Euroland', Central and East Europe and Africa as its main area (CFEOT 1999: 4). A monetary triadization of the world economy was imminent, but the yen was lagging behind in this process, because of its limited use in East Asia. The Asian crisis provided an opportunity for a change of the regional monetary regime as most East Asian countries unlinked their currencies from the dollar. MOF claimed that the pegging of regional currencies to the dollar had been a major cause of the 1997 crisis and recommended that East Asian currencies were tied to a basket consisting of the US dollar, the Euro, and the yen.

In a speech in April 1999 Miyazawa, argued that East Asian savings were invested in the West, while the region relied on unstable capital flows from US and

European investors.¹⁷ These financial flows should be redirected to go within East Asia. Japan would play a key role at the center of the regional financial flows, channeling aid and public investment to the region. Internationalization of the yen, financial liberalization, the creation of new financial instruments and tax rebates would attract regional yen holdings into private and public securities (Miyazawa 1999).

Regionalization of the yen was also promoted through Japan's foreign aid. Loans made under the Miyazawa plan were denominated in yen. In addition, it has been discussed to use aid loans to promote yen-denominated exports from poor East Asian countries to Japan to shield these countries from uncertainties relating to the volatile yen/dollar exchange rate (Yahoo 2000).

Regional currency swaps

The discussion so far has mainly focused on the role of Japanese initiatives. Yet in May 2000 a new regional initiative for monetary co-operation was launched within the ASEAN+3 framework in a meeting of finance ministers in Chiang Mai. A network of bilateral currency swap arrangements should ensure that countries with significant currency reserves would lend foreign currency, mainly dollars, to defend the exchange rates of their neighbors. Japan was a driving force.

The Miyazawa Plan of autumn 1998 had included bilateral currency swap agreements with South Korea and Malaysia. These arrangements were extended under the Chiang Mai framework. Six bilateral swap arrangements between Japan-Korea, Japan-Thailand, Japan-the Philippines, Japan-Malaysia, China-Thailand, and China-Japan have been concluded and signed since the Chiang Mai Agreement with a combined size of US\$ 17 billion. Another eight bilateral agreements are being negotiated, while the existing swap arrangements between Japan-Korea and Japan-Malaysia with the combined size of US\$ 7.5 billion have been renewed.

¹⁷ Miyazawa was echoing the argument presented during the September 1997 IMF/World Bank meeting in Hong Kong by Chief Executive of the Hong Kong Monetary authority, Joseph Yam: 'Much of Asian savings, in particular official sector savings and private sector savings that have been institutionalised, are still invested in assets of OECD countries ... [M]ore than 80 per cent of total Asian foreign exchange reserves amounting to US\$ 600 billion are invested largely in North America and Europe ... It can be argued therefore that Asia is financing much of the budget deficit of developed economies, particularly the United States, but has to try hard to attract money back into the region through foreign investments. And the volatility of foreign portfolio investments has been a major cause of disruptions to the monetary and financial systems of the Asian economies. Some have even gone so far as to say that the Asian economies are providing the funding to hedge funds in non-Asian countries to play havoc with their currencies and financial markets'. See Yam (1997: 9-10).

There has also been extensive discussion within the ASEAN+3 on the pegging of regional currencies to some 'basket' of the dollar, the yen and the Euro, rather than to the dollar (ASEAN homepage; Bello 2000; Chiu 2002; Rowley 2000a, b).

Through these actions the problems of establishing, a formal institution which might counter US opposition has been bypassed. This strategy has apparently been successful. Reportedly the US representatives at the ADB meeting in Chiang Mai were not amused when the currency swap plans surprisingly were announced. Yet the United States has kept a low profile, while IMF's managing director Horst Kohler has said that an Asian Monetary Fund that is complementary to the IMF is acceptable (Liu 2002).

Another impediment against the AMF was Chinese resistance. As was previously noted, China's support of the US/IMF line during 1997/98 was motivated by its interest in obtaining concessions from the United States in negotiations regarding China's WTO accession. However, these hopes were frustrated. During 1999 relations between the United States and China were rapidly declining following the US bombing of Chinese embassy in Belgrade in the war with Yugoslavia and the issuing of the 'Cox Report' with a hawkish position on China. By mid-1999 Beijing had abandoned the strategy of accommodating the United States. It now took a greater interest in regional arrangements and supported the process leading up to the May 2000 Chiang Mai proposal (Bowles 2002: 257-258). Apparently China and Japan sorted out their differences prior to the meeting and found a formula that smacked less of 'yen hegemony'.

Conclusion

This paper has identified US hegemony and regional suspicion of Japan, especially from China, as major obstacles to East Asian regional monetary integration. The process leading up to the Chiang Mai framework may have succeeded in removing these obstacles with regard to the regional pooling of monetary resources for emergencies. It is however much harder to dispense with the regional dollar bloc and expand the order to promote increased use of regional currencies, especially the yen.

The link between monetary *seigniorage* and the US role as East Asia's 'consumer of last resort' may be a strong impediment to East Asian monetary integration. As was noted in section 2, US *seigniorage* has allowed for two decades of huge current account deficits to the benefit of East Asian exporters. The lowering of the US interest rate in 1998 helped East Asia to lower its own interest rates and export its way out of the crisis. Given East Asia's large export share to the United States,

there is likely to be great reluctance among East Asian governments against engaging in forms of economic regionalism that might trigger retaliatory US protectionist measures and jeopardize US export markets.

A future East Asian ‘de-dollarization’ can be prepared by an increase in intra-regional trade through further expansion of intra-regional producer networks, and – especially – through finished goods trade. The proposals for an ASEAN+3 Free Trade Zone might possibly be one step in this direction. However, Chinese–Japanese rivalry is a possible impediment. For instance China’s proposal for a free trade zone including itself and ASEAN has recently been countered by a Japanese proposal for an East Asia Free Trade Zone including most of East Asia, and possibly also Australia, New Zealand and the United States! (Nyt fra Asien 2002).¹⁸ What the outcome of this rivalry might be remains to be seen.

Increased Japanese imports from the region is key to the promotion of East Asian trade. Formal trade agreements may not suffice for this purpose. It may also require a major change of the strategy of Japanese companies towards increased foreign investment in production for Japanese markets. As Japan’s economic stagnation continues, it is however unlikely that this change will take place.

East Asia’s dependence on the United States may also be reduced ‘by default’ through a major crash and import contraction in the United States. In case of recession or stagnation in the United States as well as in Japan the East Asian governments may finally face a tough choice which they have been postponing for decades thanks to the US role as the region’s ‘consumer of last resort’. A new home-market oriented development strategy might be needed, e.g. through improved public welfare. This would require a change of deeply rooted policies and power relations oriented to constraining domestic consumption. This would be an extremely difficult task, requiring greater autonomy of East Asian states towards their upper classes than seen so far, based on new class alliances which included East Asian lower classes.

¹⁸ Paul Bowles (2002: 260-262) relates the new Japanese interest in regional trade arrangements to MITI’s (currently METI, the Ministry of Economy, Trade and Industry) effort at promoting Japanese interests in multilateral trade negotiations through a regional framework.

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